

**DRAFT**

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

**Telecommunications Division  
Carrier Branch**

**RESOLUTION T-16687  
December 5, 2002**

**RESOLUTION**

RESOLUTION T-16687. VERIZON CALIFORNIA INC (U-1002-C).  
REQUEST TO PROVIDE LOCAL PACKAGE STANDARD, LOCAL  
PACKAGE, AND LOCAL AND TOLL PACKAGE, WHICH INCLUDE  
CUSTOM CALLING AND CUSTOM LOCAL AREA SIGNALING  
SYSTEM (CLASS) FEATURES BUNDLED WITH BASIC RESIDENCE  
EXCHANGE SERVICE.

BY ADVICE LETTER (AL) NOS. 9952, 9952-A, AND 9952-B, FILED ON  
DECEMBER 21, 2001, JANUARY 14, 2002, AND JUNE 20, 2002,  
RESPECTIVELY.

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**Summary**

This resolution rejects Verizon California Inc.'s (Verizon) request in Advice Letter Nos. 9952, 9952-A and 9952-B (ALs) to offer three packages that consist of flat-rate basic residence exchange service (1FR) plus a bundle of custom calling and Custom Local Area Signaling System (CLASS) features because Verizon's proposals do not comply with the bundling requirements set forth in our decisions.

**Background**

On December 21, 2001, Verizon filed AL No. 9952, supplemented by AL Nos. 9952-A and 9952-B on January 14, 2002 and June 20, 2002, respectively, to offer three telephone service packages that include Custom Calling and CLASS features with 1FR service. The three packages are *Local Package Standard*, *Local Package*, and *Local and Toll Package*.

The *Local Package Standard* consists of 1FR service, unlimited Zone Usage Measurement (ZUM) service,<sup>1</sup> and a choice of up to three vertical features as follows:

Call Waiting/Cancel Call Waiting	Three-Way Calling
Distinctive Ring	Busy Redial
*69	Priority Call
Speed Dialing 30	Caller ID
Flexible Call Forwarding	Anonymous Call Block
Call Block	Do Not Disturb
Select Call Forwarding	

The *Local Package* includes 1FR service, unlimited ZUM service, plus a choice of four or more of the vertical features listed above. Finally, the *Local and Toll Package* includes 1FR service, unlimited ZUM service, choice of any combination of the thirteen vertical features listed above, a Home Voice Mail Standard Package, and direct-dialed intraLATA regional toll allowance of 300 minutes of usage per month.<sup>2</sup> Under Verizon's proposal, a ULTS customer would not be eligible to subscribe to the packaged services unless the subscriber agrees to be converted from a ULTS to 1FR service.

## Notice/Protests

Verizon states that a copy of AL Nos. 9952, 9952-A, and 9952-B, and related tariff sheets were mailed to competing and adjacent utilities and/or other utilities. Notice of the ALs were published in the Commission Daily Calendar of December 28, 2001, January 18, 2002, and June 24, 2002, respectively. On January 22, 2002, the Office of Ratepayer Advocates (ORA) protested the ALs because ORA believes that, among other things, Verizon's offerings redefine basic service, discriminate against ULTS customers, and that the packaged services do not cover their respective costs.

Verizon responded to ORA's protest on January 29, 2002. Verizon argues that the service offerings in its ALs do not redefine the basic definition of basic service and do not discriminate against ULTS customers. Verizon also contends that each package covers its imputed costs, meets the Category (CAT) II and CAT III bundling requirements set forth in D.96-03-020 and that each service in the bundled packages is offered on a stand-alone basis at a higher rate.

## Discussion

Decision (D.) 96-03-020 permits LECs to bundle CAT II and III services "*as long as*

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<sup>1</sup> Verizon sought authority to offer unlimited ZUM service in AL No. 10129, filed June 20, 2002. AL No. 10129 is contingent on approval of a ZUM price floor requested in AL No.10121, filed June 11, 2002.

<sup>2</sup> IntraLATA toll usage exceeding 300 minutes per month will be rated at \$0.05 per minute.

*customers are able to purchase the individual services separately at tariffed rates, and proper imputation of price floors for each separately unbundled CAT II service is verified.”*<sup>3</sup> The packages offered in the ALs do not meet the first requirement because the unlimited ZUM service contained in the *Local Package* and the *Local and Toll Package* can’t be purchased separately as an individual service, nor can the 300 minute IntraLATA toll usage plan contained in the *Local and Toll Package* be purchased separately as an individual service. The ALs do not meet the second bundling requirement, as there are no Commission-approved price floors established for either 1FR or ZUM services.

In D.94-09-065, the Commission required that prior to a local exchange carrier (LEC) exercising pricing flexibility for a CAT II service, it must first establish a price floor for the service.<sup>4</sup> D.96-03-020 moved basic exchange services (including 1FR) from CAT I to CAT II, and thus this service is subject to price floor and imputation requirements established by D.89-10-031 (as modified by D.94-09-065 and D.99-11-050) as well as the bundling requirements established by D.96-03-020.

Therefore, before Verizon can bundle 1FR service or unlimited ZUM with custom calling services and CLASS features indicated in the ALs, it must first establish a price floor for 1FR and ZUM.<sup>5</sup> Because Verizon’s 1FR and ZUM services do not yet have Commission-approved price floors, Verizon’s bundling of the 1FR and unlimited ZUM services with other services does not meet the bundling requirements set forth in D.96-03-020. D.96-03-020 states:

*“PU Code §§ 453, 532, and 2882.5 together require LECs to demonstrate, prior to the offering of a package, the imputed underlying costs of any Category II service bundled with a Category III or nonregulated service.”* (Conclusion of Law No. 41 )

Verizon asserts that it has complied with this requirement because it has priced its 1FR service at its current tariffed rate established by the Commission with no request for pricing flexibility. TD disagrees.

D.99-12-018 granted Verizon authority to implement interim pricing flexibility through the advice letter process for those services reclassified in D.96-03-020 as CAT II services (including 1FR and ZUM service). Verizon has only requested price floors for ZUM service,<sup>6</sup> but not for 1FR service.<sup>7</sup> Even if ZUM price floors are established in the near

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<sup>3</sup> D.96-03-020, 65 CPUC 2<sup>nd</sup> at 194.

<sup>4</sup> D.94-09-065, 56 CPUC 2<sup>nd</sup> at 263.

<sup>5</sup> “When packaging residential services, the existing imputation rules should apply.” D.96-03-020 Conclusion of Law (COL) 47, 65 CPUC 2<sup>nd</sup> at 213.

<sup>6</sup> Verizon’s price floor request is currently being reviewed by TD and may be approved prior to Commission meeting of November 7, 2002.

future, Verizon may not package 1FR service with other telephone services because it lacks Commission-approved price floors for its 1FR service.

In summary, TD concludes that the requirements for bundled packages contained in D.96-03-020 must be met before Verizon may offer the packages of services proposed in its ALs. Consequently, TD recommends that Verizon's proposals be rejected because they do not comply with Commission requirements as explained in the preceding paragraphs.

Because Verizon's ALs do not meet our price floor and bundling requirements and may be rejected for these reasons, it is unnecessary to address ORA's contention that the proposed bundled services unduly discriminate against ULTS customers. For the reasons discussed in this resolution, we find TD's recommendation to reject Verizon's proposals in AL No. 9952 and its supplemental AL filing Nos. 9952-A and 9952-B to be appropriate and reasonable.

The draft resolution of the TD in this matter was mailed to the parties in accordance with PU Code Section 311(g). Comments were filed on October 22, 2002 by Verizon California, Inc. No reply comments were filed.

In its comments on the draft resolution, Verizon argues that it has requested a price floor for its ZUM service, and that the Commission's approval of Verizon's ZUM price floor request is overdue. In essence, Verizon argues that the Commission is responsible for the lack of ZUM price floors and the consequent failure of the ALs to satisfy the Commission's rules. As stated above, even if an approved price floor for ZUM was in place Verizon's ALs must still be rejected because Verizon has no Commission-approved price floor for the 1FR service contained in the proposed offerings, and because Verizon's unlimited ZUM service and its 300 minute IntraLATA toll usage offering can not be purchased separately.

With respect to establishing price floors for 1FR, Verizon argues that different pricing rules should apply to bundling 1FR with other services than those it apparently concedes apply to bundling ZUM with other services. Verizon relies on D.98-07-091 to support its position, asserting that "*basic residential service should be treated differently than other Category II services.*"<sup>8</sup> Verizon's reliance on D.98-07-091 is misplaced.

In rehearing D.96-03-020, D.98-07-091 addressed the narrow issue of how the contribution of shared and common costs embedded in any California High Cost Fund B (CHCF-B) subsidy should be treated when determining price floors for bundles

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<sup>7</sup> Verizon's cost for 1FR is being addressed in the OANAD proceeding (R.93-04-003/I.93-04-002).

<sup>8</sup> Comments of Verizon California on Draft Resolution T-16687 at 4.

containing subsidized basic service. The modification considered by the Commission was intended “*[to prevent] the LEC from enriching itself unfairly by engaging in below-cost pricing of Category III services subsidized by use of the CHCF-B subsidy payment attributable to shared and common costs.*”<sup>9</sup>

D.98-07-091 modified D.96-03-020 to require that “*LECs impute into the price floor of a bundled service that includes basic service, the total long-run incremental cost of basic service, plus the contribution of basic service toward the LEC’s shared and common costs identified in D.96-10-066.*”<sup>10</sup> Importantly, Verizon’s rendition of the price floor formula fails to accurately reflect this important requirement, because Verizon’s restatement of the price floor formula incorrectly replaces the term “*the total long-run incremental cost of basic service*” with the term “*Tariffed Rate for Basic Service.*”<sup>11</sup> Because Verizon’s current tariffed rate for 1FR service is likely to be lower than its asserted cost for the service<sup>12</sup>, Verizon’s formula impermissibly imputes a “negative contribution” to the 1FR price floor resulting in prices that are below their costs.<sup>13</sup>

D.98-07-091 acknowledged that “*the definition of contribution is being debated in [the Open Access and Network Architecture Development (OANAD) proceeding]*”, and concludes that the interim procedure it established for imputing the contribution of shared and common costs embedded in CHCF-B subsidy “*should sunset with the issuance of the pricing orders in OANAD.*”<sup>14</sup> However, in 1998, Verizon petitioned the Commission requesting authority to establish interim price floors until such time that price floors are established in OANAD.

D.99-12-018 explicitly granted Verizon authority to establish interim price floors for services reclassified by D.96-03-020 and directed it to develop price floors using the methodology approved in D.99-11-050. D.99-11-050 determined that the imputation method established by D.94-09-065 remains valid, concluding that “*the contribution method of imputation should be used in setting price floors for the services specified in FOF 69*

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<sup>9</sup> D.98-07-091, 81 CPUC 2<sup>nd</sup> at 342.

<sup>10</sup> Ibid, Ordering Paragraph No. 2 at 344.

<sup>11</sup> Comments of Verizon California on Draft Resolution T-16687 at 5.

<sup>12</sup> Were Verizon’s proposed costs for 1FR filed in R.93-04-003/I.93-04-002 adopted without change and used to establish a price floor, the prices proposed in the ALs would fail the Commission’s imputation/price floor requirements.

<sup>13</sup> The Commission has established three tests to ensure a proposed price floor equals or exceeds the appropriate price floor. The third test (No Negative Contribution) states, “*The contribution could be negative if the tariff rate was less than the LRIC for the monopoly building block...If the contribution term is negative, the resulting price floor would be below the LRIC of the bundled service, and, as a result, the bundled Category II service would be priced below cost. This result would be anticompetitive and would violate our pricing policies.*” D.94-09-065, 56 CPUC 2<sup>nd</sup> at 235.

<sup>14</sup> D.98-07-091, 81 CPUC 2<sup>nd</sup> at 342.

*[i.e., 1FR, 1MR, 1MB, Business ISDN, Residence ISDN, Business ZUM, Residence ZUM, Business local usage, Residence local usage, COPT].*"<sup>15</sup> Moreover, the procedures adopted in D.94-09-065 for establishing price floors remain in effect, as do the rules adopted in D.96-03-020 for bundling services.

Verizon asserts that it may bundle 1FR with other services without an established price floor for 1FR. In support of its position, Verizon states:

*"Verizon's proposed offering also meets the second requirement of D.96-03-020 [that 'proper imputation of price floors for each separately unbundled Category II service is verified'] because the price of each proposed package exceeds the combined imputed cost of the individual services that comprise the package... The only service that does not have an approved price floor in the packages is residential flat-rate service. Because a price floor has not been approved for this service, its price floor is set at the current weighted-tariff rate, as expressly required by the Commission. Indeed, in D.96-03-020, the Commission stated that '[u]ntil appropriate price floors are approved, the LECs shall be required to continue pricing these services at existing tariffed rates.'"*<sup>16</sup>

Verizon's argument fails in two ways. First, our bundling rules require *verification of price floors for each separately unbundled CAT II service contained in a bundle*.<sup>17</sup> The requirement to verify price floors for each service contained in a package is intended to ensure that there is no improper cross-subsidization of one or more services contained in the package by other services in the package. D.96-09-065 states, *"If the price of each rate element is above its LRIC, then we can be assured that no potential exists for anticompetitive subsidization of the rate elements making up the competitive service."*<sup>18</sup>

Merely assuring that the price of each proposed package exceeds the combined imputed cost of the individual services that comprise the package does not satisfy the requirement to verify the price floors *for each* separately unbundled CAT II service contained in the package. Therefore, the ALs do not comply with our price floor verification rules.

D.96-03-020 also addresses two related but distinct issues of "pricing flexibility" and "bundling" of the services reclassified from CAT I to CAT II, including 1FR service. Because the reclassified services did not have price floors in place at the time they were reclassified, the Commission conditioned the exercising of *pricing flexibility* for those

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<sup>15</sup> D.99-11-050, Conclusion of Law (COL) No. 76.

<sup>16</sup> See, for example, Verizon January 29, 2002 Response to ORA's Protest at 2.

<sup>17</sup> D.96-03-020, 65 CPUC 2<sup>nd</sup> at 194.

<sup>18</sup> D.94-09-065, 56 CPUC 2<sup>nd</sup> at 231 - 232.

services on the establishment of price floors.<sup>19</sup> However, the Commission separately determined that *bundling* would be permitted “*as long as no ‘tying arrangements’ are involved and our imputation rules are strictly observed.*”<sup>20</sup> Thus, Verizon’s argument incorrectly relies on provisions applicable to pricing flexibility to support its contention that it may bundle services that do not have established price floors. To be clear, D.96-03-020 permits the offering of reclassified services on a stand-alone basis without price floors in place (and with no pricing flexibility), but requires price floors to be in place when the reclassified (or any other CAT II) services are included as part of a bundle or package.

Verizon asserts that it does not and will not have permanent unbundled network element (UNE) prices for sometime, and must therefore comply with what it believes is required under D.98-07-091. We find this argument to be unpersuasive. The imputation and price floor requirements for combining Verizon’s own services offerings into packages are independent of the prices that other carriers must pay Verizon for the use of UNEs. D.99-12-018 granted Verizon authority to establish interim price floors for services reclassified by D.96-03-020 using the methodology in D.99-11-050. Thus, interim price floors for 1FR rate elements can be set whenever Verizon chooses to request them.<sup>21</sup> To date, it has not. However, until Verizon obtains authority to set either interim or permanent price floors for 1FR, the ALs do not comply with our imputation requirements.

## Conclusion

Our rejection of Verizon’s proposals is based on the specifics of the ALs, and does not establish precedent for the contents of future filings or for Commission approval of similar requests.

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<sup>19</sup> “The LECs will be permitted to implement pricing flexibility for tariffed Category II services once relevant price floors are established for the reclassified services. The process of establishing price floors is currently underway in the OANAD proceeding. Until appropriate price floors are approved, the LECs shall be required to continue pricing these services at existing tariffed rates.” D.96-03-020, 65 CPUC 2<sup>nd</sup> at 191.

<sup>20</sup> Ibid at 193.

<sup>21</sup> “Price floor filings must fully justify and document the requested price floors. The filing should include the proposed price floor for the service and the supporting LRIC (or DEC) cost study, presented on a rate element basis. The filing must also contain a complete description, on a rate element basis, of how the Category II service is rendered.” D.94-09-065, 56 CPUC 2<sup>nd</sup> at 263.

“The filing should include well-documented cost studies and network diagrams, to help CACD confirm that all cost elements are accounted for...To guard against subsidization of competitive services, we will apply the LRIC floor on a rate element basis, rather than a service basis.” D.94-09-065, 56 CPUC 2<sup>nd</sup> at 229 - 231.

Thus, separate price floors are required for recurring and non-recurring rate elements associated with a service. With respect to non-recurring rate elements, the Commission has determined that “The cost of installing [Verizon’s] basic exchange service consists of three elements: initial order or service connection, central office activity, and premise visit.” D.94-09-065, 56 CPUC 2<sup>nd</sup> at 155.

## **Findings**

1. Verizon's proposals in AL No. 9952 and its supplemental AL filing Nos. 9952-A and 9952-B do not comply with the bundling requirements set forth in D.96-03-020.
2. D.94-09-065 required that a LEC must first establish a price floor before it can exercise pricing flexibility for CAT II services.
3. D.96-03-020 moved basic exchange services (including 1FR) from CAT I to CAT II and thus this service is subject to price floor and imputation requirements established by D.89-10-031 (as modified by D.94-09-065 and D.99-11-050) and the bundling requirements established by D.96-03-020.
4. D.96-03-020 permits bundling as long as no tying arrangements are involved and our imputation rules are strictly observed.
5. The imputation rules enunciated in D.94-09-065 and reaffirmed by D.99-11-050 require establishment of price floors for CAT II services, and require prices for CAT II services to be at or above the price floors.
6. D.99-12-018 authorized Verizon to develop interim price floors using the methodology adopted in D.99-11-050. To date, Verizon has not filed interim price floors for 1FR.
7. Verizon may not flexibly price or bundle 1FR and unlimited ZUM services with other optional service features until price floors are established for these services.
8. Verizon may not bundle unlimited ZUM service or the 300 minute IntraLATA toll usage offering unless these services are available for purchase separately as individual services.
9. Verizon's bundling of its 1FR, unlimited ZUM services and the 300 minute IntraLATA toll usage offering with custom calling services and CLASS features does not comply with the requirements for bundling services set forth in D.96-03-020.
10. Rejection of the ALs makes it unnecessary to address ORA's contention that the proposed bundled services unduly discriminate against ULTS customers.

**THEREFORE, IT IS ORDERED that:**



1. Verizon's proposals in AL No. 9952 and its supplements are rejected because they fail to meet the price floor and bundling requirements set forth in D.96-03-020. For clarity purposes, the requirements are as follows:
  - (1) Customers are able to purchase the individual services separately at tariffed rates; and
  - (2) Proper imputation of price floors for each separately unbundled CAT II service is verified.
2. Verizon shall not flexibly price or bundle 1FR with packages of other services until there are Commission-approved price floors for this service.
3. Verizon shall not bundle the 300 minute IntraLATA toll usage offering with packages of other services until this service is separately available for individual purchase.
4. Verizon shall not bundle unlimited ZUM service with packages of other services until there are Commission-approved price floors for this service and until this service is separately available for individual purchase.

This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on December 5, 2002. The following Commissioners approved it:

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WESLEY M. FRANKLIN  
Executive Director